Supreme Court, U.S.
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No. 01-

IN THE

Supreme Court of the United States

KENNETH L. LOCHBAUM, Individually, and
KEN LOCHBAUM PHYSICAL THERAPY CLINIC, INC.,

Petitioners,

v.

ST. PAUL INSURANCE COMPANIES,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

In a federal diversity jurisdiction case, a trial court concluded an issue of state law on the basis of a conflicting federal court decision. Has a federal court departed from governing legal principles and unjustifiably ignored conflicting state court opinions that determined Pennsylvania's bad faith statute is governed by a six-year catch-all statute of limitations and not a two-year "tort" statute of limitations.

PARTIES TO THE PROCEEDINGS

The original defendant, United States Fidelity and Guaranty Company, has been merged into St. Paul Insurance Companies.

STATEMENT PURSUANT TO RULE 29.6

Petitioner, Ken Lochbaum Physical Therapy Clinic, Inc., has no parent corporation and no publicly held company owns 10% or more of its stock.

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OPINIONS BELOW

The Memorandum Decision without published Opinion of the Court of Appeals for the Third Circuit (Appendix A, *infra*) is reported at 2001 U.S. App. LEXIS 17948. The Memorandum Opinion and Order of the United States District Court for the Western District of Pennsylvania (Appendix B, *infra*) is reported at 136 F. Supp. 2d 386 (W.D. Pa. 2000). The Report and Recommendation of the Magistrate Judge (Appendix C, *infra*) is reported at 2000 U.S. Dist. LEXIS 20839.

STATEMENT OF JURISDICTION

The Court of Appeals for the Third Circuit had jurisdiction of petitioner's appeal pursuant to 28 U.S.C. § 1291. The judgment of the Court of Appeals was entered on July 30, 2001. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The statutes involved here are:

1. **42 Pa. Cons. Stat. Ann. § 8371. Actions on Insurance Policies.**

> In an action arising under an insurance policy, if the Court finds that the insurer has acted in bad faith toward the insured, the Court may take all of the following actions:
>
> (1) award interest on the amount of the claim from the date the claim was made by the

insured in an amount equal to the prime rate of interest plus three percent;

(2) award punitive damages against the insurer;

(3) assess court costs and attorneys fees against the insurer.

1990 Feb. 7, P.L. 11, No. 6, § 3, effective July 1, 1990.

2. 42 Pa. Cons. Stat. Ann. § 5524. Two Year Limitation.

The following actions and proceedings must be commenced within two years:

(5) An action upon a statute for a civil penalty or forfeiture.

(7) Any other action or proceeding to recover damages for injury to person or property which is founded on negligent, intentional or otherwise tortuous conduct or any other action or proceeding sounding in trespass, including deceit or fraud, except an action or proceeding subject to another limitation specified in this sub-chapter.

As amended 1982, Dec. 20, P.L. 1409, No. 326, Art. II, § 201, effective in sixty days.

3. 42 Pa. Cons. Stat. Ann. § 5527. Six Year Limitation.

Any civil action or proceeding which is not subject to another limitation specified in this sub-chapter nor excluded from the application of a

period of limitation by §5531 (relating to no limitation) must be commenced within six years.

Amended 1982, Dec. 20, P.L. 1409, No. 326, Art. II, § 201, effective in sixty days.

STATEMENT OF THE CASE

This case involves the ongoing controversy over whether Pennsylvania's statutory bad faith cause of action is governed by a two-year "tort" statute of limitations or a six-year "catch-all" statute of limitations. This case arises under the Pennsylvania Bad Faith Statute applicable to insurers, 42 Pa. C.S.A. § 8371 which does not itself contain a statute of limitations. Petitioners filed a complaint in the Court of Common Pleas of Erie County, Pennsylvania on March 26, 2000 alleging that Respondent United States Fidelity and Guaranty Company, now by merger St. Paul Insurance Companies (hereinafter "USF&G"), acted in bad faith in adjusting a fire loss which occurred on June 12, 1994. Petitioners were named insureds under a commercial blanket policy of insurance issued by USF&G which covered a period from December 23, 1993 to December 24, 1994. The policy was issued in the face amount of $5,089,500.00 and covered the business personal property and real property located at 414 Main Street, Girard, Pennsylvania which were owned by Petitioners. On June 12, 1994 the building located on the above property was damaged and its contents were destroyed by fire causing Petitioners to sustain losses in the amount of $2,160,173.87. Petitioners contend that USF&G refused to resolve their claims under the policy with care and diligence but rather chose to take an adversarial position. Respondent insisted that the value of the loss was $750,000.00 without any basis for doing so and despite the ultimate appraisal award of $2,160,173.87. USF&G imposed

a co-insurance penalty which resulted in payment of only $1,444,799.80, which award its arbitrator ultimately refused to sign but payment being made August 29, 1996. Petitioner commenced this action against Respondent to recover damages resulting from its bad faith under Pennsylvania's bad faith statute on March 20, 2000, more than two years, but less than four years, after receipt of payment from the arbitration compelled by the Respondent.

USF&G thereafter filed a motion to dismiss or, in the alternative, for a more specific statement pursuant to Federal Rule of Civil Procedure 12(b)(6) arguing that the Petitioners' complaint failed to state a claim for either breach of contract or bad faith; that Petitioners' claims are barred by the two-year statute of limitations provided for in the policy, as well as a two-year statute of limitations set forth at 42 Pa. C.S.A. § 5524.

A. The Magistrate Judge's Report and Recommendation

On August 4, 2000 the United States Magistrate Judge Robert C. Mitchell issued a report and recommendation that Respondent's Motion to Dismiss be granted as to the Petitioners' breach of contract claim and the motion be denied in all other respects. Specifically, the Magistrate Judge found that "if the Pennsylvania Supreme Court were to address the issue, it would apply the six-year 'catch-all' statute of limitations set forth in §5527 to claims brought under §8371."

The Magistrate Judge's report and recommendation reviewed the split of authority in the District Court's sitting in Pennsylvania, represented on the one hand by *Woody v.*

State Farm Fire and Casualty Company, 965 F. Supp. 691 (E.D. Pa. 1977), applying a six-year statute of limitations and *Nelson v. State Farm Mutual Auto Insurance Company*, 988 F. Supp. 527 (E.D. Pa. 1997), applying a two-year statute of limitations period on the other. In *Woody*, *supra*, Judge Anita Brody determined that because the statute itself was silent as to the applicable statute of limitations, the most closely analogous limitation period should apply, relying on *Gabriel v. O'Hara*, 368 Pa. Super. 383, 534 A.2d 488 (1987). Judge Brody determined that Pennsylvania's statutory bad faith sounds in both tort and contract, relying on Pennsylvania's Unfair Insurance Practices Act, 4 Pa. C.S.A. § 1171 and *Romano v. Nationwide Mutual Fire Insurance Company*, 646 A.2d 1228 (Pa. Super. 1944). When two applicable yet conflicting limitation periods apply, the six-year "catch-all" statute of limitation period governs, relying on *Gabriel v. O'Hara*, *supra*, which determined that the six-year "catch-all" limitation period governs claims under the Pennsylvania Unfair Trade Practices and Consumer Protection Law ("UTPCPL"), 73 Pa. C.S.A. § 201-2.

In *Nelson*, *supra*, Judge Dalzell determined that Pennsylvania's statutory bad faith claims are governed by a two-year statute of limitations. Judge Dalzell determined that the bad faith sounds strictly in tort and lacks any significant basis in contract because the statute includes a remedy for punitive damages and is separate and distinct from the underlying contract claim. In addition, Judge Dalzell relied upon the Pennsylvania Supreme Court's refusal to create a "new tort" of bad faith in *D'Ambrosio v. National Mutual Insurance Company*, 494 Pa. 501, 431 A.2d 966 (1981). Judge Dalzell determined that resolution of a bad faith claim requires inquiry into the reasonableness of the insurer's conduct and, finally, that twenty-nine other states have characterized their bad faith statutes as tort actions.

Magistrate Judge Roberts concluded that the *Woody* opinion of Judge Brody was the better reasoned and properly followed the majority of Pennsylvania Common Pleas Courts which had decided the issue, particularly, *Mantia v. Northern Ins. Co. of New York*, 39 Pa. D. & C.4th 71 (C.P. Lanc. Co. 1998).

B. The District Court Decision

On August 22, 2000 the Respondent filed objections to the report and recommendation of the Magistrate Judge. On September 28, 2000 Judge Sean J. McLaughlin of the Western District of Pennsylvania declined to accept the Magistrate's recommendation that the statute of limitations for claims under § 8371 is six years and issued an order granting Respondents' Motion to Dismiss Petitioner's Complaint. Judge McLaughlin determined that § 8371 prescribes an obligation that is derived from tort law because the obligation to act in good faith is one of reasonableness. Although the Court noted its obligation to consider the decisions of lower state Courts and give them greater weight than a conflicting decision of the Federal Court, Judge McLaughlin chose, however, to follow the conflicting Federal Court decision which is in a minority among the Pennsylvania Courts which have decided the issue and concluded that a six-year limitation period applies.

C. The Third Circuit Decision

On July 30, 2001, by a 3 to 0 decision without published opinion, the Court of Appeals for the Third Circuit affirmed the District Court's judgment. Judge Fuentes held that the District Court did not err in electing to follow the *Nelson* line of reasoning in predicting how the Pennsylvania

Supreme Court would conclude that an action under § 8371 would be governed.

REASONS FOR GRANTING THE WRIT

The decision in this case gave little or no weight to the Pennsylvania Common Pleas Court decisions, a majority of which have determined that § 8371 is governed by the six-year statute of limitations under 42 Pa. C.S.A. § 5527. The decision also discounts the analogous decision of the Pennsylvania Superior Court in *Gabriel v. O'Hara*, 368 Pa. Super. 383, 534 A.2d 488 (1987), which determined that claims under the Unfair Trade Practices and Consumer Protection Law ("UTPCPL"), 73 Pa. C.S.A. § 201-2, are governed by a six-year statute of limitation. Such a decision poses a serious threat to the doctrine of *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 58 S. Ct. 817 (1938), that state issues should be resolved by reference to state law as to call for review by this court.

Here, neither the Supreme Court of Pennsylvania nor the legislature have addressed this issue. In predicting how the Pennsylvania Supreme Court would decide the issue were it confronted with the problem, the Federal Court must consider relevant state precedents, analogous decisions, considered dicta, scholarly works, and any other reliable data tending convincingly to show how the highest Court in the state would decide the issue at hand. The rule of *Erie* requires the Federal Court to apply state law and not to participate in an effort to change it merely because its soundness is in doubt. *McKenna v. Ortho Pharmaceutical Corp.*, 622 F.2d 657, 661 (3d Cir. 1980); *see also Packard v. Providence Nat'l Bank*, 994 F.2d 1039, 1047 (3d Cir. 1993); *Nationwide Insurance Company v. Ressequie*, 980 F.2d 226, 230 (3d Cir.

1992). Because a Federal Court's prediction of state law, until and unless overruled by the State Supreme Court, tends to "verge on the lawmaking function" of the highest State Court, it is critical that the Federal Court do all within its power to view the problem before it as a State Court would, and not through the eyes of a court steeped in Federal law." *See* Dolores K. Sloviter, *A Federal Judge Views Diversity Jurisdiction Through the Lens of Federalism*, 78 Va. L. Rev. 1671, 1681-82 (1992); *Packard, id.* Accordingly, it must be recognized that a decision of a lower state court on a point of state law is generally more predictive of what the state Supreme Court would hold than is a conflicting opinion in a Federal Court on the same point. *Packard, id.*

Although a Pennsylvania Common Pleas opinion is not binding on a Federal Court under the *Erie* doctrine, such an opinion is "indicative of what the law of Pennsylvania may be." *Brown v. Moore*, 247 F.2d 711, 721 (3d Cir. 1957). Currently there are three Common Pleas decisions which have considered the issue and determined that a six-year statute of limitations applies. *See Copeland v. Farmers Mutual Insurance Company of McCandless County*, 82 Erie L.J. 27 (C.P. Erie 1999) (applying a six-year period on the ground that such § 8371 claims are *sui generis* and embody elements of both tort and contract claims); *Hospital Shared Services v. CIGNA*, 41 Pa. D. & C.4th 148 (C.P. Alleg. Co. 1998) (applying a six-year period on the ground that § 8371 creates a private cause of action for claims under the Unfair Trade Practices Act, 40 P.S. §§ 1171.1-1171.15, and that such causes of action arise under statutorily-created obligations as well as under tort law); *Mantia v. Northern Ins. Co. of New York*, 39 Pa. D. & C.4th 71 (C.P. Lanc. Co. 1998) (applying a six-year statute on the ground that bad faith claims embody elements of both tort and contract).

Both the decisions in *Woody*, *supra* and *Nelson*, *supra*, were decided before these State Court opinions were rendered. These State Court opinions provide persuasive insight into how the Pennsylvania Supreme Court would decide this issue, particularly in light of the Superior Court of Pennsylvania's decision in the analogous case of *Gabriel v. O'Hara*, 368 Pa. Super. 383, 534 A.2d 488 (1987).

The District Court and the Third Circuit did not accurately predict Pennsylvania law as they are required to do as an *Erie*-bound Federal Court. Little attention was given to the State Court's opinions which were decided after the Federal District Court decisions and are a better predictor of state law. Neither Court pointed to any convincing evidence that the Pennsylvania Supreme Court would not follow the State Court decisions. Thus, relying on a conflicting Federal Court decision does not comport with accepted legal principles set forth by this Court for diversity jurisdiction. *Fidelity Union Trust Co. v. Field*, 311 U.S. 169, 61 S. Ct. 176 (1940).

CONCLUSION

The Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — MEMORANDUM OPINION AND JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DATED AND FILED JULY 30, 2001

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 00-3552

KENNETH L. LOCHBAUM, individually, and
KEN LOCHBAUM PHYSICAL THERAPY CLINIC, INC.,

Appellants

v.

UNITED STATES FIDELITY AND GUARANTY COMPANY, now by merger, ST. PAUL INSURANCE COMPANIES.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA

(D.C. Civil No. 00-cv-00154)
District Judge: Honorable Sean J. McLaughlin

Submitted Under Third Circuit LAR 34.1(a)
July 10, 2001

BEFORE: SLOVITER, ALITO, and FUENTES,
Circuit Judges.

(Filed: July 30, 2001)

Appendix A

MEMORANDUM OPINION OF THE COURT

FUENTES, *Circuit Judge.*

Appellants Kenneth L. Lochbaum, individually ("Lochbaum"), and Ken Lochbaum Physical Therapy Clinic, Inc. ("the Clinic"), appeal from an order entered on September 28, 2000 in the United States District Court for the Western District of Pennsylvania, dismissing, pursuant to Fed. R. Civ. P. 12(b)(6), their claims against United States Fidelity and Guaranty Company, now by merger, St. Paul Insurance Companies ("USF&G"), as time barred. We have jurisdiction under 28 U.S.C. § 1331. Exercising plenary review, *see Tourscher v. McCullough*, 184 F.3d 236, 240 (3d Cir. 1999), we will affirm.

I.

Because we write for the parties, we provide only a brief summary of the background and procedural history of this case. On June 12, 1994, a fire damaged real and personal property owned by the appellants and insured under a commercial policy issued by USF&G. Shortly thereafter, appellants filed a claim with USF&G. In 1996, an arbitration panel issued an award valuing the loss at $2,160,173.73.

On March 20, 2000, appellants commenced this action in the Court of Common Pleas of Erie County, Pennsylvania, alleging that USF&G had acted in bad faith in adjusting the fire loss. The case was removed to the United States District Court for the Western District of Pennsylvania. Subsequently, USF&G filed a Motion to Dismiss under Fed. R. Civ. P.

12(b)(6), arguing that appellants' claims were time-barred by the two-year statute of limitations applicable to tort actions under Pennsylvania law, 42 Pa. Const. Stat. Ann. § 5524(7). On September 28, 2000, the District Court, rejecting a Magistrate Judge's report and recommendation, granted USF&G's Motion to Dismiss, agreeing with USF&G that the two-year statute of limitations applied.

On October 17, 2000, appellants filed notice of appeal.

II.

On appeal, appellants argue that the District Court erred as a matter of law in predicting that the Pennsylvania Supreme Court would apply the two-year tort statute of limitations to Pennsylvania's bad faith statute. They submit that, if faced with the issue, the Pennsylvania Supreme Court would apply Pennsylvania's six-year "catch-all" statute of limitations period, 42 Pa. Const. Stat. Ann. § 5527. However, they concede that if the six-year statute of limitation does not apply, then their claims are time-barred.

Pennsylvania's bad faith statute, 42 Pa. Const. Stat Ann. § 8371,[1] does not define "bad faith," establish the necessary

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1. Specifically, 42 Pa. Const. Stat. Ann. § 8371 provides:

> In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith towards the insured, the court may take all of the following actions:

(Cont'd)

elements for a bad faith cause of action, or specify the statute of limitations applicable to such claims. Moreover, to date, the Pennsylvania Supreme Court has not opined on what the appropriate statute of limitations is. As the parties note, both Federal and intermediate State Courts are split on the issue.

In the absence of an opinion from a state's highest court on a matter of state law, a federal court sitting in diversity should predict how that state court would rule if confronted with the issue. *Packard v. Provident Nat'l Bank*, 994 F.2d 1039, 1046 (3d Cir. 1993).

In the present case, the District Court based its prediction and holding on the comprehensive legal analysis set out by Judge Dalzell in *Nelson v. State Farm Mut. Auto. Ins. Co.*, 988 F. Supp. 527 (E.D. Pa. 1997). In *Nelson*, Judge Dalzell concluded that an action for bad faith is to be considered a tort claim, governed by Pennsylvania's two-year statute of limitations, 42 Pa. C.S.A. § 5524. The court noted that bad faith causes of action in Pennsylvania have historically been treated as torts. *See Nelson*, 988 F. Supp. at 531 (citing

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(Cont'd)

1. Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%.

2. Award punitive damages against the insurer.

3. Assess court costs and attorney fees against the insurer.

42 Pa. Const Stat. Ann. § 8371.

D'Ambrosio, 431 A.2d at 977). It emphasized the "emerging jurisprudence" among the lower courts in Pennsylvania that have treated an action for bad faith under § 8371 as a "separate and distinct cause of action from the underlying contract claim." *Id.* at 532. In concluding that the two-year statute applied, the court ultimately relied upon a "basic understanding of torts and contracts." On this, it stated:

> . . . torts concerns itself with standards of conduct that society imposes. Contracts concerns itself with promises the parties themselves make and exchange. Bad faith is more akin to the former than to the latter because it is precisely such an exogenous standard.

Id. at 533.

Here, we believe that the District Court properly elected to follow the *Nelson* line of reasoning in predicting how the Pennsylvania Supreme Court would conclude that an action under § 8371 would be governed. Thus, the District Court correctly held that appellants' claims are time-barred under Pennsylvania's two-year tort statute of limitations.

III.

Accordingly, for the reasons stated, we will affirm.

TO THE CLERK:

Please file the foregoing opinion.

/s/ Julio M. Fuentes
Circuit Judge

Appendix A

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 00-3552

KENNETH L. LOCHBAUM, individually, and
KEN LOCHBAUM PHYSICAL THERAPY CLINIC, INC.,

Appellants

v.

UNITED STATES FIDELITY AND GUARANTY
COMPANY, now by merger, ST. PAUL
INSURANCE COMPANIES.

ON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE WESTERN DISTRICT
OF PENNSYLVANIA

(D.C. Civil No. 00-cv-00154)
District Judge: Honorable Sean J. McLaughlin

Submitted Under Third Circuit LAR 34.1(a)
July 10, 2001

BEFORE: SLOVITER, ALITO, and FUENTES,
Circuit Judges.

JUDGMENT

Appendix A

This cause came to be considered on the record from the United States District Court for the Western District of Pennsylvania and was submitted pursuant to Third Circuit LAR 34.1(a) on July 10, 2001.

On consideration whereof it is now ordered and adjudged by this court that the order of the District Court entered on September 28, 2000, is hereby AFFIRMED. Costs taxed against appellants. All of the above in accordance with the opinion of this Court.

ATTEST:

s/ Marcia M. Waldron
Clerk

Dated: July 30, 2001

APPENDIX B — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA DATED AND FILED SEPTEMBER 28, 2000

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

CA. NO. 00-154 ERIE

KENNETH L. LOCHBAUM, individually
and KEN LOCHBAUM PHYSICAL
THERAPY CLINIC, INC.,

Plaintiffs,

vs.

UNITED STATES FIDELITY & GUARANTY
COMPANY, now by merger ST. PAUL
INSURANCE COMPANIES,

Defendant.

MEMORANDUM OPINION

McLAUGHLIN, J.

This case arises under the Pennsylvania bad faith statute applicable to insurers, 42 Pa. Cons.Stat. Ann. § 8371.[1] We

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1. In its entirety, this statute provides:

> In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward

(Cont'd)

have jurisdiction pursuant to 28 U.S.C. § 1331, and are asked to determine the proper statute of limitations for section 8371 claims. The Defendant has filed a Motion to Dismiss pursuant to Fed.R.Civ.P. 12(b)(6) on the ground that the Plaintiffs' action is time-barred. In the alternative, the Defendant has filed a Motion for a More Definite Statement pursuant to Fed.R.Civ.P. 12(e). Magistrate Judge Robert C. Mitchell issued a Report and Recommendation regarding this matter on August 4, 2000. For the reasons that follow, we decline to accept the Magistrate's recommendation that the statute of limitations for section 8371 claims under Pennsylvania law is six years. Because we find that the statute of limitation is two years, we grant the Defendant's Motion to Dismiss on the ground that Plaintiffs' claim is time-barred and do not reach the Motion for a More Definite Statement.

(Cont'd)

> the insured, the court may take all of the following actions:
>
> (1) Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%.
>
> (2) Award punitive damages against the insurer.
>
> (3) Assess court costs and attorney fees against the insurer.

42 Pa. Cons.Stat. Ann. § 8371.

Appendix B

I. Background

On June 12, 1994, a fire severely damaged real property and destroyed personal property owned by the Plaintiffs and insured by a commercial policy issued by then United States Fidelity & Guaranty Company and now by merger St. Paul Insurance Companies (hereinafter "Defendant"). (*See* Complaint, ¶¶ 8-10). Shortly thereafter, the Plaintiffs filed a claim with the Defendant and allege that, throughout its handling, the Defendant pursued a course of bad faith conduct that resulted in a delayed recovery and damages including but not limited to lost profits, rents, and costs from a demanded arbitration. (*See* Complaint, ¶¶ 16-39). The specific instances of behavior alleged to have been undertaken in bad faith are numerous and immaterial to this discussion. In 1996, the Plaintiffs were ultimately awarded $2,160,173, an amount significantly greater than the $778,000 offered to resolve the claim in 1994. (*See* Complaint, ¶¶ 23, 30). The Plaintiffs commenced this action on March 20, 2000.[2]

II. Standard of review

A motion to dismiss under Rule 12(b)(6) is evaluated by accepting all allegations in the complaint as true and viewing them in the light most favorable to the plaintiffs. *See Gould Electronics Inc. v. United States*, 220 F.3d 169 (3d Cir.2000) (citing *In re Burlington Coat Factory Securities Litigation*, 114 F.3d 1410, 1420 (3d Cir.1997)).

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2. The Plaintiffs concede that if either a two or four-year statute of limitations period applies, their action is time-barred.

The proper inquiry is "whether relief could be granted . . . 'under any set of facts that could be proved consistent with the allegations.' " *Gasoline Sales, Inc. v. Aero Oil Co.*, 39 F.3d 70, 71 (3d Cir.1994) (quoting *National Organization for Women, Inc. v. Scheidler*, 510 U.S. 249, 256 (1994)). If no cause of action can be identified, dismissal is proper.

III. Discussion

Section 8371 does not contain a statute of limitations provision, and the Pennsylvania Supreme Court has yet to determine which of several potential limitations periods applies to actions under the statute. The possibilities include the two-year period applicable to "action[s] upon a statute for a civil penalty" and tort actions, 42 Pa. Cons.Stat. Ann §§ 5524(5), 5524(7),[3] the four-year period applicable to contract actions, 42 Pa. Cons.Stat. Ann. § 5525(8),[4] and the

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3. In pertinent part, section 5524 provides:

> The following actions and proceedings must be commenced within two years: . . . (5) an action upon a statute for a civil penalty or forfeiture . . . (7) Any other action or proceeding to recover damages for injury to person or property which is founded on negligent, intentional, or otherwise tortious conduct or any other action or proceeding sounding in trespass, including deceit or fraud, except an action or proceeding subject to another limitation specified in this subchapter.

42 Pa. Cons.Stat. Ann. §§ 5524(5), 5524(7).

4. In pertinent part, section 5525 provides:

> The following actions and proceedings must be

(Cont'd)

six-year "catchall" period applicable to actions that do not fall into an enumerated category and are not excepted from the application of a limitations period, 42 Pa. Cons.Stat. Ann § 5527.[5]

In the absence of an opinion from a state's highest court on a matter of state law before it, a federal court sitting in diversity must predict how that court would rule on the matter if it were confronted with it. *See Packard v. Provident National Bank*, 994 F.2d 1039, 1046 (3d Cir.1993). In making this determination, the court must consider "relevant state precedents, analogous decisions, considered dicta, scholarly works, and any other reliable data tending convincingly to show how the highest court in the state would decide the issue at hand." *Id.* Given the decision of a lower state court

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(Cont'd)

> commenced within four years: . . . (8) An action upon a contract, obligation or liability founded upon a writing not specified in paragraph (7), under seal or otherwise, except an action subject to another limitation specified in this subchapter.

42 Pa. Cons.Stat. Ann. § 5525(8).

5. Section 5527 provides:

> Any civil action or proceeding which is neither subject to another limitation specified in this subchapter nor excluded from the application of a period of limitation by section 5531 (relating to no limitation) must be commenced within six years.

42 Pa. Cons.Stat. Ann. § 5527.

and a conflicting decision of a federal court, the opinion of the state court is given greater weight. *See id.* at 1047.

The Pennsylvania state courts that have addressed the applicable statute of limitations for section 8371 claims have reached conflicting conclusions. *See Susich v. Prudential Property & Cas. Ins. Co.*, 35 Pa. D. & C.4th 178 (Ct.C.P. Beaver Co.1998) (applying a two-year period on ground that bad faith claims fall into both the "civil penalty" and tort categories); *Mantia v. Northern Ins. Co. of New York*, 39 Pa. D. & C.4th 71 (Ct.C.P. Lanc. Co.1998) (applying a six-year period on ground that bad faith claims embody elements of both tort and contract); *Hospital Shared Services v. CIGNA Ins. Co.*, No. GD95-2956 (Ct.C.P. Allegh. Co.1998) (applying a six-year period on ground that section 8371 creates a private cause of action for claims under the Pennsylvania Unfair Insurance Practices Act, 40 Pa. Stat.Ann §§ 1171.1-1171.15, and that such causes of action arise under statutorily created obligations as well as under tort law); *Copeland v. Farmers Mutual Fire Ins. Co. of McCandless County*, No. 11219-1997, 82 Erie Co. L.J. 27 (Ct.C.P. Erie Co. 1997) (applying a six-year period on ground that section 8371 claims are *sui generis* and embody elements of both tort and contract).

Likewise, the federal courts in Pennsylvania that have faced the issue have divided between the two and six-year possibilities. *See Nelson v. State Farm Mut. Aut. Ins. Co.*, 988 F.Supp. 527 (E.D.Pa.1997); *Friel v. Unum Life Ins. Co. of America*, No. CIV. A. 97-1062, 1998 WL 8003336 (E.D.Pa.1998); *McCarthy v. Scottsdale Ins. Co.*, No. C.A. 99-978, 1999 WL 672642 (E.D.Pa.1999); *Mantakounis v.*

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Aetna Cas. & Sur. Co., No. CIV A. 98-4392, 1999 WL 600535 (E.D.Pa.1999); *Liberty Mut. Fire Ins. Co. v. Corry Indus.*, C.A. 97-172E (W.D.Pa.2000) (each applying a two-year period), and *Woody v. State Farm Fire & Cas. Co.*, 965 F.Supp. 691 (E.D.Pa.1997); *Kosierowski v. Allstate Ins. Co.*, 51 F.Supp.2d 583 (E.D.Pa.1999); *Miller v. The Cincinnati Insurance Co.*, No. 97-CV-1223 (E.D.Pa.1997) (each applying a six-year period). We find it useful to set forth the rationale of both lines of cases as well as the history of the bad faith claim.

The cases that have applied a two-year period have largely characterized claims under section 8371 as tort actions. In explanation, these courts have discussed or noted the development of the bad faith claim generally. *See Nelson*, 988 F.Supp. at 531-34; *McCarthy*, 1999 WL at *3. Beginning with the landmark decision of the California Supreme Court in *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032 (Cal. 1973), a majority of jurisdictions have recognized the bad faith claim in both the third and first-party contexts as a tort action distinct from a breach of contract claim on the insurance contract. *See Nelson*, 988 F.Supp. at 533-34 (noting that at least twenty-nine jurisdictions appear to characterize the first-party bad faith claim as a common law tort and citing Douglas R. Richmond, *The Two Way Street of Insurance Good Faith: Under Construction, But Not Yet Open*, 28 Loy. U. Chi. L.J. 95, 107 n.74 (1996)). As the California court stated in *Gruenberg:*

> The duty violated — that of dealing fairly and in good faith with the other party to a contract of insurance — is a duty imposed by law, not one

> arising from the terms of the contract itself. In other words, this duty of dealing fairly and in good faith is nonconsensual in origin rather than consensual. Breach of this duty is a tort. *Gruenberg*, 510 P.2d at 1037 (internal citations omitted).

Under this rationale the duty breached in a bad faith action arises from the relationship of the contracting parties rather than from the terms of the insurance contract. This action more closely resembles a tort than a contract because the standard of conduct is an exogenous one rather than one derived from specific contract terms. *See Nelson*, 988 F.Supp. at 533.

The cases that have applied a six-year period, on the other hand, have generally determined that actions under section 8371 may sound in either tort or contract, and therefore fall into the six-year "catchall" period because they cannot be exclusively characterized as one or the other. *See Woody*, 965 F.Supp. at 693-94; *Mantia*, 39 Pa. D. & C. 4th at 76. In *Woody*, Judge Brody referenced the broad definition of bad faith used in the insurance context for this proposition, and also identified the Pennsylvania Unfair Insurance Practices Act ("UIPA") as "lend[ing] further support that actions under § 8371 can sound in either tort or contract." *Woody*, 965 F.Supp. at 694. According to Judge Brody, some of the practices prohibited by UIPA sound in tort while others sound in contract. *See id.* In reaching bad faith determinations, Pennsylvania courts regard conduct constituting a violation of the UIPA as one of several relevant factors. *See O'Donnell v. Allstate Ins. Co.*, 734 A.2d 901, 906 (Pa. Super. Ct. 1999).

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The general history of bad faith claims is complicated in Pennsylvania by the Pennsylvania Supreme Court's decision in *D'Ambrosio v. Pennsylvania Nat'l Mut. Cas. Ins. Co.*, 431 A.2d 966 (1981). In this case, the court declined to create a common law bad faith claim, stating that "[t]here is no evidence to suggest, and we have no reason to believe, that the system of sanctions established under the Unfair Insurance Practices Act must be supplemented by a judicially created cause of action." *Id.* at 970. Nine years after *D'Ambrosio*, the state legislature enacted section 8371. This decision and the legislature's response have produced divergent views on the substantive basis of the statute.

In *Nelson*, Judge Dalzell stated that "the Pennsylvania Supreme Court in D'Ambrosio contemplated the creation of a tortious cause of action for bad faith, but explicitly left the creation of such an action to the discretion of the General Assembly. There is also little doubt that § 8371 owes its existence to D'Ambrosio's invitation." *Nelson*, 988 F.Supp. at 532. In *Hospital Shared Services*, however, Judge Wettick stated in disagreement that "[a]t the most, the invitation was to create a private cause of action based on the unfair practices enumerated within the [Unfair Insurance Practices] act rather than to create a new tort." *Hospital Shared Services*, No. GD95-2956 at 4. Because Judge Wettick further found that the UIPA in part established new obligations having little or no relationship to tort law, he held that actions under section 8371 are governed by the six-year period of limitations. *See id.*

The pivotal inquiry, in our view, is whether section 8371 prescribes an obligation that is derived from tort law, the

terms of the insurance contract, or some other source of law such as the UIPA. Despite the consideration Pennsylvania courts give to conduct that violates the UIPA in determining whether insurers have acted in bad faith and the factual connection to an insurance contract that every section 8371 claim bears, we regard the obligation imposed by the statute as a tort duty. The Pennsylvania Superior Court has adopted the definition of bad faith contained in *Black's Law Dictionary*, which provides that bad faith is:

> . . . any frivolous or unfounded refusal to pay proceeds of a policy; it is not necessary that such refusal be fraudulent. For purposes of an action against an insurer for failure to pay a claim, such conduct imports a dishonest purpose and means a breach of a known duty (i.e. good faith and fair dealing), through some motive of self-interest or ill will; mere negligence or bad judgment is not bad faith. *O'Donnell*, 734 A.2d at 905 (Pa. Super. Ct. 1999) (quoting *Romano v. Nationwide Mut. Fire Ins. Co.*, 646 A.2d 1228, 1232 (Pa. Super. Ct. 1994)).

We agree with the *Nelson* court's statement that "[s]uch an inquiry into the reasonableness of the insurer's behavior, to see whether it is perhaps more than mere negligence or bad judgment bears the classic earmarks of the law of torts." *Nelson*, 988 F.Supp. at 533. At its core, the duty allegedly breached in a bad faith action in Pennsylvania and elsewhere is the basic obligation of an insurer "to act in good faith and deal fairly with its insureds so as not to deprive the insured of the very benefits for which he or she has contracted."

The Best Place, Inc. v. Penn America Ins. Co., 920 P.2d 334, 343 (Haw. 1996). This obligation is fundamentally one of reasonableness, and although the specifics of what is reasonable in the insurance context may be in part derived from other statutes such as the UIPA and/or contract terms, we understand the duty itself to derive from tort law.[6] It is imposed because of the relationship between the insurer and the insured, and not because of these other statutes or contract terms. That the duty is informed by these sources does not, in our view, change its character as a tort obligation.

In *Woody*, Judge Brody also noted that application of the six-year period would avoid the inconsistency and uncertainty that would emerge from a case-by-case selection of the two or four-year period depending on whether a particular case sounded in contract or tort. *See Woody*, 965 F.Supp. at 695. Because we find that section 8371 actions sound exclusively in tort, we note that there is no possibility for this inconsistency to develop. Further, we agree with Judge Dalzell that, even assuming section 8371 actions could in some instances sound in contract, it makes little sense to apply a limitations period that is the sum of the relevant possibilities. "Put another way, given the options of two or four years, it does not strike us as a reasonable reading to add the two periods together." *Nelson*, 988 F.Supp. at 534 n.11.

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6. The Pennsylvania Superior Court has held that, in evaluating the conduct of an insurer under section 8371, trial courts may consider: "(1) other cases construing the statute and the law of 'bad faith' generally; (2) the plain meaning of the term(s) used in the statute; and/or (3) other statutes upon the same or similar subjects . . ." *Romano v. Nationwide Mut. Fire Ins. Co.*, 646 A.2d 1228, 1233 (Pa. Super. 1994).

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IV. CONCLUSION

For the reasons above, we predict that the Pennsylvania Supreme Court, if confronted with the issue, would hold that section 8371 claims are subject to the two-year statute of limitations provided in 42 Pa. Cons.Stat. Ann. § 5524(7). Because we so hold, we find that the Plaintiffs' action is time-barred and grant the Defendant's Motion to Dismiss pursuant to Fed.R.Civ.P. 12(b)(6).

Appendix B

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

CA. NO. 00-154 ERIE

KENNETH L. LOCHBAUM, individually
and KEN LOCHBAUM PHYSICAL
THERAPY CLINIC, INC.,

Plaintiffs,

vs.

UNITED STATES FIDELITY & GUARANTY
COMPANY, now by merger ST. PAUL
INSURANCE COMPANIES,

Defendant.

ORDER

AND NOW, this 28th day of September 2000, IT IS HEREBY ORDERED that the Defendant's Motion to Dismiss pursuant to Fed.R.Civ.P 12(b)(6) be and hereby is granted.

s/ Sean J. McLaughlin
Sean J. McLaughlin
United States District Judge

APPENDIX C — REPORT AND RECOMMENDATION OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF PENNSYLVANIA DATED AUGUST 4, 2000

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

Civil Action No. 00-154 E

KENNETH L. LOCHBAUM, individually, and KENNETH LOCHBAUM PHYSICAL THERAPY CLINIC, INC.,

Plaintiff,

vs.

UNITED STATES FIDELITY & GUARANTY COMPANY, now by merger ST. PAUL INSURANCE COMPANIES,

Defendant.

REPORT AND RECOMMENDATION

I. *Recommendation*

It is respectfully recommended that defendants' motion to dismiss, or in the alternative, for a more definite statement (Docket No. 3) be granted as to plaintiffs' claim for breach of contract, to the extent plaintiffs intended to bring such a claim, and that the breach of contract claim be dismissed, and that the motion be denied in all other respects.

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II. *Report*

Presently before this Court for disposition is a motion to dismiss, or in the alternative, for a more definite statement brought by the defendants, United States Fidelity & Guaranty Co. ("USF&G") and St. Paul Fire & Marine Insurance Co. ("St. Paul") (collectively "defendants").[1]

Plaintiffs Kenneth L. Lochbaum, individually ("Lochbaum"), and Kenneth Lochbaum Physical Therapy Clinic, Inc. ("the Clinic") (collectively "plaintiffs"), commenced this action as the result of defendants' alleged bad faith in resolving a fire insurance claim made by plaintiffs under a policy issued by defendants.

According to the complaint, plaintiffs were named insureds under a commercial blanket policy of insurance ("the Policy") issued by USF&G which covered the period from December 23, 1993 to December 24, 1994.[2] The Policy was issued in the face amount of $5,089.500.00.[3] The Policy covered the business personal property and the real property located at 415 Main Street, Girard, Pennsylvania, which were owned by plaintiffs.[4] On June 12, 1994, the building located

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1. Defendants contend that St. Paul has been incorrectly named in the complaint as "St. Paul Insurance Companies." *See* Notice of Removal (Docket No. 1).

2. Complaint ¶ 6.

3. Complaint ¶ 7.

4. Complaint ¶¶ 8, 10, 11.

on the above property was damaged and its contents were destroyed by fire causing plaintiffs to sustain losses in the amount of $2,160,173.87.[5] Plaintiffs allege that defendants refused to resolve their claims under the Policy with care and diligence but rather "chose to take an adversarial position."[6] Plaintiffs further contend that defendants acted in bad faith by failing to act with care and diligence; by failing to effect full and broad coverage for their losses; by failing to make and complete a prompt, careful, and diligent investigation into the value of the loss in question; by acting in a threatening and intimidating manner; by asserting that plaintiff Kenneth Lochbaum may be guilty of misrepresentation; by failing to act with honesty toward plaintiffs; by deciding to inventory all items found at all locations including all non-business personal property found at those locations despite the fact that they were not covered under the Policy; by unreasonably failing to pay plaintiff for a first party loss covered under the Policy; by making blatant and subtle misrepresentations of the Policy and coverage provisions; by failing to act with reasonableness but rather by acting in a confrontational manner; by requesting proof of compliance with the 90% co-insurance provisions of the Policy despite the fact that no claim had yet been perfected; by insisting that the value of the loss was $750,775.00 without any basis for doing so and despite the appraisal award of a $2,160.173 loss; by failing to establish and maintain reasonable standards for promptly investigating claims; by failing to affirm or deny coverage in a reasonable time; by compelling the insured to litigate

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5. Complaint ¶¶ 8, 9, 12.

6. Complaint ¶¶ 13, 14.

the loss in order to collect a valid claim and by offering substantially less than that actually recovered in arbitration and demanded by plaintiffs; by failing to promptly notify plaintiffs of and explain the reasons for its claim denial; by failing to make a good faith effort to effectuate a prompt, fair and equitable settlement of the claims in which liability had become clear; by failing to issue the necessary claim forms to plaintiffs so that plaintiffs could comply with the Policy conditions and reasonable requirements of the insurer; and by failing to properly utilize depreciation figures and failing to cap depreciation by establishing a utility base.[7] As a result of defendants' acts of bad faith, plaintiffs contend that they have suffered losses in the amount of $2,300,450.63 stemming from lost rental income, lost net income, lost sales profits, the differential in ACV of the loss and the amount recovered, and fees paid to a public adjusting service.[8]

Plaintiffs filed the instant complaint in the Court of Common Pleas of Erie County, Pennsylvania on March 26, 2000, alleging defendants' bad faith and on May 26, 2000, defendants removed the case to this Court pursuant to 28 U.S.C. § 1332(a)(1).[9]

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7. Complaint ¶¶ 16-38.

8. Complaint ¶ 39.

9. It appears undisputed that upon commencement of this action plaintiff Lochbaum was an individual residing in the Commonwealth of Pennsylvania; the Clinic was a corporation organized and existing under the laws of Pennsylvania; that defendant USF&G was incorporated under the laws of the State of Maryland with its

(Cont'd)

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Defendants have now filed a motion to dismiss, or in the alternative, for a more definite statement arguing that the complaint fails to state a claim for either breach of contract or bad faith; that plaintiffs' claims are nevertheless barred by the two-year statute of limitations provided for in the insurance policy itself; and that they are barred by the two-year statute of limitations set forth in 42 Pa.C.S.A. § 5524.

In reviewing a motion to dismiss under Rule 12(b)(6), all well-pleaded allegations of the complaint must be accepted as true and viewed in a light most favorable to the non-movant. *Brader v. Allegheny General Hospital*, 64 F.3d 869, 873 (3d Cir. 1995); *Scrob v. Patterson*, 948 F.2d 1402, 1405 (3d Cir. 1991). The Court is not, however, required to accept as true unsupported conclusions and unwarranted references. *Schuylkill Energy Resources v. PP&L*, 113 F.3d 405, 417 (3d Cir. 1997), *cert. denied*, 522 U.S. 977 (1997). Thus, "if it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief," the motion to dismiss is properly granted. *Haines v. Kerner*, 404 U.S. 519, 520-21 (1972) quoting *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). *See Ala, Inc. v. CCAir*, *supra*. The issue is not whether the plaintiff will prevail in the end but only whether he should be entitled to offer evidence in support of his claim. *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974).

(Cont'd)
principal place of business in Baltimore, Maryland; and that defendant St. Paul was incorporated under the laws of the State of Minnesota, maintaining its principal place of business in St. Paul, Minnesota. *See* Notice of Removal (Docket No. 1).

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Defendants initially contend that plaintiffs have failed to state a claim for breach of contract arguing that although the complaint makes passing reference to the insurance contract at issue plaintiffs have failed to allege that defendants breached the contract or otherwise pled any facts to support such a claim. *See Gundlach v. Reinstein*, 924 F. Supp. 684, 689 (E.D. Pa. 1996), *affirmed*, 114 F.3d 1172 (3d Cir. 1997). Plaintiffs have not responded to this argument in their responsive brief and, therefore appear to have conceded the issue. Accordingly, to the extent that plaintiffs may have intended to bring a claim for breach of contract, that portion of the complaint should be dismissed for failure to state a claim. We also note, as discussed below, that if the breach of contract claim were to procedurally survive, it would be subject to dismissal as time barred.

Defendants also contend that plaintiffs have failed to state a claim for bad faith as the complaint is devoid of any reference to 42 Pa.C.S.A § 8371, which provides the only basis upon which a plaintiffs may bring a cause of action for bad faith against an insurer in Pennsylvania.[10] Plaintiffs do

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10. 42 Pa.C.S.A. § 8371 provides:

> In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward the insured, the court may take all of the following actions:
>
> (1) Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3 percent.

(Cont'd)

not dispute defendants' contention that no common law cause of action for insurance bad faith exists or that their cause of action is properly brought under § 8371. Nor do plaintiffs dispute that the complaint lacks any reference to the statute. Rather, plaintiffs suggest that a specific reference to the statute is not required and that they have nevertheless pled a valid cause of action for bad faith under § 8371. We agree.

In *Continental Casualty Co. v. Diversified Industries, Inc.*, 884 F. Supp. 937 (E.D. Pa. 1995), the plaintiff filed suit seeking a declaratory judgment that it was not obligated to provide coverage for costs incurred for cleaning-up hazardous material at the defendant's metal reclamation facility since the damage was caused, in part, by the defendant. The defendant filed a counterclaim for bad faith which the plaintiff moved to dismiss arguing, *inter alia*, that because no common law cause of action for bad faith is recognized in Pennsylvania and, because the defendant failed to cite § 8371 in its counterclaim, it is precluded from proceeding under the bad faith statute. The District Court for the Eastern District of Pennsylvania disagreed finding that "a plaintiff need not allege the exact statutory or constitutional basis for his or her claim" as long as sufficient facts have been pled to enable the court to ascertain the potential viable legal theories. *Id.* at 962, and cases cited therein. *See Hammie v. Social Security Administration*, 765 F. Supp. 1224, 1227 n.4 (E.D. Pa. 1991) ("Plaintiffs are required to plead facts, not legal theories.")

(Cont'd)

(2) Award punitive damages against the insurer.

(3) Assess court costs and attorney fees against the insurer.

Thus, it does not appear that the instant plaintiffs' failure to cite to § 8371 is fatal to their claim of bad faith as long as the complaint sets forth a sufficient factual basis for the statutory claim.

Although bad faith is not defined in § 8371, the Pennsylvania courts have typically held that to succeed on a claim of bad faith in an insurance context a plaintiff must demonstrate that (1) the defendant did not have a reasonable basis for denying benefits under the policy and (2) that the defendant knew or recklessly disregarded its lack of reasonable basis for denying the claim. *Terletsky v. Prudential Property and Cas. Ins. Co.*, 649 A.2d 680, 688 (Pa. Super. 1994), *allocatur denied*, 659 A.2d 560 (Pa. 1995). *See Klinger v. State Farm Mut. Auto. Ins. Co.*, 115 F.3d 230, 233 (3d Cir. 1997).

Here, it appears that plaintiffs have set forth sufficient facts from which it can be inferred that defendants denied coverage, that they did so without a reasonable basis, and that they knew or should have known that they lacked a reasonable basis. As such, it appears that they have properly stated a claim under § 8371 and defendants' motion to dismiss is properly denied.

Defendants also argue that even if plaintiffs have stated a claim for bad faith that their claim is barred by the two-year statute of limitations set forth in the Policy which provides that:

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No one may bring a legal action against us under this Coverage Part unless:

1. There has been full compliance with all of the terms of this Coverage Part; and

2. The action is brought within 2 years after the date on which the direct physical loss or damage occurred.

The Policy, Commercial Property Conditions, Section D.[11] Because the damage to plaintiffs' property occurred on June 12, 1994, and the complaint in this matter was not filed until March 20, 2000, or almost six years later, defendants conclude that the instant suit is untimely. Defendants rely on *Fennell v. Nationwide Mutual Fire Insurance Co.*, 603 A.2d 1064 (Pa. Super.), *allocator denied*, 617 A.2d 1274 (Pa. 1992), for the proposition that limitation provisions contained in insurance policies are consistently upheld in Pennsylvania.

While limitations provisions in insurance contracts appear to be binding where claims sounding in contract have been raised, they do not appear applicable to claims of bad faith brought under § 8371. Indeed, both the Pennsylvania courts and the federal courts have held that bad faith claims brought under § 8371 are separate and distinct from an underlying contract claim and that bad faith claims are not affected by a limitations period contained in the insurance

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11. A copy of the Policy is attached to the Complaint (Docket No. 1).

contract. *See Younis Brothers & Co. v. CIGNA Worldwide Insurance Co.*, 899 F. Supp. 1385, 1396 (E.D. Pa. 1995), *affirmed*, 91 F.3d 13 (3d Cir. 1996), *and cert. denied*, 519 U.S. 1077 (1997) ("Claims under § 8371 remain viable even if the statute of limitations has run on the contract claim . . . or if the insured has failed to file suit within the period required by the policy."); *Margolies v. State Farm Fire and Casualty Co.*, 810 F. Supp. 637, 642 (E.D. Pa. 1992) ("The evolving jurisprudence in this district has held that § 8371 creates a separate and independent cause of action. . . . Thus, even if plaintiffs' breach of contract claim were barred by the policy's limitation provision, the § 8371 bad faith claim would survive, since it is independent of the underlying claims."); *March v. Paradise Mutual Insurance Co.*, 646 A.2d 1254 (Pa. Super. 1994), *allocator denied*, 656 A.2d 118 (Pa. 1995) ("The bad faith claim is not affected by the one-year limitations period in the insurance contract.").

It therefore appears that the two-year limitations period set forth in the Policy is inapplicable and does not serve to bar to plaintiffs' claim for bad faith under § 8371. *Id.*

Finally, defendants argue that plaintiffs' claim is nevertheless barred under 42 Pa.C.S.A. § 5524 which sets forth a two-year statute of limitations for actions sounding in tort. Plaintiffs counter that because an action brought under § 8371 sounds in both contract and tort that the six-year "catch-all" statute of limitations set forth in 42 Pa.C.S.A. § 5527 should apply.[12]

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12. The dispute, of course, is predicated on the fact that § 8371 does not provide for a statute of limitations.

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Although the Pennsylvania appellate courts have yet to address what limitations period applies to § 8371 actions the issue is not a novel one. Indeed, the United States District Court for the Eastern District of Pennsylvania has been called upon to resolve the dispute on a number of occasions resulting in a split of authority that is represented on one hand by *Woody v. State Farm Fire & Casualty Co.*, 965 F. Supp. 691 (E.D. Pa. 1997) ("*Woody*") (applying a six-year statute of limitations), and *Nelson v. State Farm Mutual Auto Insurance Co.*, 988 F. Supp. 527 (E.D. Pa. 1997) ("*Nelson*") (applying a two-year limitations period) on the other. In our view, the rational set forth in *Woody* and its progeny is the more persuasive of the two leading us to conclude that the Supreme Court of Pennsylvania would likely apply the six-year statute of limitations to cases brought under § 8371.

In *Woody*, Judge Anita Brody's analysis and ultimate decision is premised on the notion that when a statute itself is silent regarding the applicable statute of limitations the Pennsylvania courts generally apply "the most closely analogous limitations period." *Woody*, *supra* at 693, quoting *Gabriel v. O'Hara*, 534 A.2d 488, 494 (Pa. Super. 1987). In order to ascertain an analogous cause of action. Judge Brody began by assessing the meaning of "bad faith" as used in the insurance context:

> "Bad Faith" on part of insurer is any frivolous or unfounded refusal to pay proceeds of a policy; it is not necessary that such refusal be fraudulent. For purposes of an action against an insurer for failure to pay a claim, such conduct imports a

> dishonest purpose and means a breach of a known duty (i.e., good faith and fair dealing), through some motive of self-interest or ill will; mere negligence or bad judgment is not bad faith.

Id., quoting *Polselli v. Nationwide Mutual Fire Insurance Co.*, 23 F.3d 747, 751 (3d Cir. 1994). Noting that this definition contemplates fraudulent activity as well as the implied covenant of good faith and fair dealing the Court found that a claim for bad faith sounds in both tort and contract. Judge Brody found further support for this conclusion in the Pennsylvania's Unfair Insurance Practices Act ("UIPA"), 40 Pa.C.S.A. § 1171, et seq., which defines and prohibits unfair methods of competition or unfair or deceptive acts or practices in the insurance industry including actions sounding in tort and contract.[13]

Under Pennsylvania law, however, the limitations period for acts sounding in tort is two years pursuant to 42 Pa.C.S.A. § 5524, while an action for breach of contract is subject to a four-year limitations period under 42 Pa.C.S.A. § 5525. Thus, the Court in *Woody* was faced with two applicable yet conflicting limitation periods. To resolve the conflict, Judge Brody looked to the Pennsylvania Superior Court's opinion in *Gabriel v. O'Hara*, *supra*, wherein the Court, confronted with conflicting opinions on the issue, was asked to

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13. The Court's reliance on the UIPA in the context of a § 8371 claim appears to be proper under *Roman v. Nationwide Mutual Fire Insurance Co.*, 646 A.2d 1228 (Pa. Super. 1994), which held that "a trial court may consider the kinds of unfair practices prohibited under the UIPA to evaluate whether an insurer's conduct constitutes bad faith under § 8371." *Woody*, *supra* at 694.

determine the appropriate statute of limitations for a cause of action brought pursuant to the Pennsylvania Unfair Trade Practices and Consumer Protection Law ("UTPCPL"), 73 Pa.C.S.A. §§ 201-2, et seq. While the trial court found that the purpose of the statute was to protect the consumer from *fraud* and applied the two-year limitations period under 42 Pa.C.S.A. § 5524, the District Court for the Eastern District of Pennsylvania had previously applied a one-year statute of limitations pursuant to 42 Pa.C.S.A. § 5523, finding that the plaintiff's trade disparagement claim brought under the UTPCPL in that case was essentially a claim for *libel*. *Merv Swing Agency, Inc. v. Graham Co.*, 579 F. Supp. 429 (E.D. Pa. 1983). Noting the need for consistency where a statute could sound in two different causes of action and finding that, because of the *sui generis* nature of the statute, no explicit statute of limitations applied, the *Gabriel* Court concluded that the six-year "catch-all" statute of limitations under 42 Pa.C.S.A. § 5527 should govern.[14] *Gabriel*, *supra* at 494-95.

Relying on *Gabriel*, the Court in *Woody*, recognized the need for consistency in applying a limitations period under § 8371, which also sounds in two different causes of action, and found that no explicit limitations period for claims brought under § 8371 had been provided by the legislature.

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14. 42 Pa.C.S.A. § 5527 provides in relevant part:

> Any civil action or proceeding which is neither subject to another limitation specified in this subchapter nor excluded from the application of a period of limitation by section 5531 (relating to no limitation) must be commenced within six years.

Woody, *supra* at 695. Because § 5527 of the Judicial Code directs that actions not subject to any other statute of limitations are governed by a six-year limitations period, Judge Brody held that the Pennsylvania Supreme Court would likely apply the six-year "catch-all" statute of limitations. *Id.*

Following the decision in *Woody*, the Eastern District of Pennsylvania was again asked to decide what the applicable statute of limitations was under § 8371 in *Nelson v. State Farm Mutual Automobile Insurance Co.*, *supra*. This time, however, District Judge Dalzell decided the issue and reached the opposite result predicting that the Pennsylvania Supreme Court would likely conclude that § 8371 sounded exclusively in tort. His prediction was based, in part, upon his finding that § 8371 lacked any significant basis in contract law, noting that punitive damages, which is a remedy provided for under § 8371, are not recoverable in an action for breach of contract. *Id.* at 529. The Court also minimized the presence of contract law in § 8371 by citing to the emerging case law which holds that § 8371 is a separate and distinct cause of action from the underlying contract claim. *Id.* at 529-30.

Having discounted the relevance of contract law in § 8371 cases, Judge Dalzell then addressed the degree to which § 8371 sounded in tort taking into consideration the history of bad faith as a cause of action, the nature of had faith as a cause of action, and the approaches taken by other state supreme courts.

With respect to the history of bad faith claims, Judge Dalzell looked largely to the Pennsylvania Supreme Court's

decision in *D'Ambrosio v. Pennsylvania National Mutual Casualty Insurance Co.*, 431 A.2d 966 (Pa. 1981) ("*D'Ambrosio*"), wherein the Court was asked to create a common law cause of action for bad faith. Judge Dalzell found that the *D'Ambrosio* Court, in recognizing that other states had created a "new tort" for bad faith but declining to do so itself, had nevertheless invited the Pennsylvania legislature to enact such a statute. Noting that the legislature subsequently enacted § 8371, Judge Dalzell concluded not only that it was at the behest of the Court in *D'Ambrosio*, but that the statute necessarily sounds in tort. *Nelson*, *supra* at 531-32.

Judge Dalzell also found that the nature of a bad faith action suggests that § 8371 sounds in tort since resolution of a bad faith claim requires inquiry into the reasonableness of an insured's conduct, thus, "bear[ing] the classic earmarks of the law of torts." *Id.* at 533.

Finally, Judge Dalzell drew support for his conclusion from other courts which have decided the issue noting that twenty-nine states which have enacted a statute similar to § 8371 have characterized it as an action in tort. *Id.* Thus, Judge Dalzell held that the Pennsylvania Supreme Court would likely conclude that § 8371 sounded exclusively in tort and applied the corresponding two-year statute of limitations. *Id.*

Faced with these conflicting opinions we are persuaded that Judge Brody's opinion in *Woody* is the better-reasoned of the two and that the Pennsylvania Supreme Court would hold that § 8371 sounds in both contract and tort and that

the absence of an explicit applicable limitations period mandates that § 5527 governs. We reach this conclusion not just from Judge Brody's opinion itself but from the well-reasoned opinion authored by Judge Stengel in *Mantia v. Northern Insurance Co.*, 39 Pa. D. & C.4th 71 (1998) ("*Mantia*"), in which he analyses both the *Woody* and *Nelson* decisions and convincingly points out why Judge Dalzell's reasons for his decision are less than compelling.

For example, Judge Stengel points out that although Judge Dalzell cites the Pennsylvania Supreme Court's decision in *D'Ambrosio* for the proposition that bad faith must be viewed exclusively as a tort, the *D'Ambrosio* Court actually held that the plaintiff could not bring an action in tort against the insurer because the facts alleged did not state a cause of action in tort. *Id.* at 75. *See D'Ambrosio, supra* at 971. As well, although the Court in *D'Ambrosio* acknowledged that California had created what it deemed a "new tort" to protect insureds from bad faith conduct by insurers, the *D'Ambrosio* Court expressly declined to follow suit finding that the Pennsylvania legislature had already taken steps to limit bad faith by insurers when it enacted the Unfair Insurance Practices Act ("UIPA") which, in Judge Brody's view, "serves adequately to deter bad faith conduct." *D'Ambrosio, supra* at 970. Thus, the question of whether § 8371 sounded in tort or contract was never reached by the *D'Ambrosio* Court and, as pointed out by Judge Stengel, it did not hold, as the *Nelson* Court implies, that a cause of action for bad faith would necessarily sound in tort. *Mantia, supra* at 77-78.

Relying on the Court of Appeals for the Third Circuit's opinion in *Polselli v. Nationwide Mutual Fire Insurance Co.*,

126 F.3d 524 (3d Cir. 1997), Judge Stengel also takes issue with the *Nelson* Court's finding that § 8371 cannot be considered a contract action since it contemplates the possibility of punitive damages. *Id.* at 80. In *Polselli*, the Court discussed at length the contractual characteristics of a bad faith claim and found that "the insurer's duty of good faith, therefore, is *contractual*." *Polselli*, *supra* at 530.

In addition, Judge Stengel disputes Judge Dalzell's finding that recognizing a new tort is justified because of the nature of a bad faith claim, stating that:

> Rather than recognizing that the bad faith claim contains elements of both tort and contract. Nelson insists on defining the cause of action as exclusively one or the other.
>
> * * *
>
> In its analysis of the nature of a bad faith cause of action, Nelson engages in a gratuitious "balancing" of the tort and contract characteristics of a bad faith action, which is not authorized by section 5527.
>
> The question presented is not whether a bad faith action looks more like a tort action than a contract action. The question is whether a bad faith action is subject to another limitation other than section 5527.

Id. at 81. Reiterating that nothing in the statutory language suggests a specific statute of limitations is applicable and that the cause of action has elements of both contract and tort to which no one limitation period applies, Judge Stengel found, as did Judge Brody in *Woody*, that § 5527 necessarily controls.[15] *Id.* at 82.

Finally, although the *Nelson* court found it significant that 29 states which have recognized a cause of action for bad faith have categorized it as one sounding in tort, Judge Stengel points out that of equal significance is the fact that 22 states have either declined to find that the cause of action sounds exclusively in tort, have not adopted the cause of action in the first instance or have not addressed the issue. *Id.* at 82-83. Judge Stengel also notes that several state supreme courts have held that a cause of action for bad faith sounds exclusively in contract. *Id.* at 83, and cases cited therein.

Thus, in our view, Judge Stengel's opinion sufficiently calls into question the reasons relied upon by Judge Dalzell in *Nelson* and at the same time persuasively outlines, as have other courts, why Judge Brody's reasoning in *Woody* is more compelling. *See Hospital v. Shared Services v. CIGNA Insurance Co.*, 41 Pa. D. & C.4th 148 (1998) (distinguishing Nelson and holding that the six-year "catch-all" statute of

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15. Notably, in discussing the contractual aspect of § 8371, Judge Dalzell found only that the statute "does not sound exclusively a contract law" thereby apparently recognizing that it sounds at least in part, in contract law. *Nelson, supra* at 529. Having acknowledged as much. Judge Dalzell's conclusion that § 8371 sounds in tort alone is even less compelling.

limitations is applicable to § 8371 actions.). As such, we believe that if the Pennsylvania Supreme Court were to address the issue, it would apply the six-year "catch-all" statute of limitations set forth in § 5527 to claims brought under § 8371. Having raised their claim within that time frame, it appears that plaintiffs' claim is properly before the Court.

For these reasons, it is recommended that defendants' motion to dismiss, or in the alternative, for a more definite statement (Docket No. 3) be granted as to plaintiffs' claim for breach of contract, to the extent they may have intended to bring such a claim, and denied in all other respects.

Within ten (10) days of being served with a copy, any party may serve and file written objections to this Report and Recommendation. Any party opposing the objections shall have seven (7) days from the date of service of objections to respond thereto. Failure to file timely objections may constitute a waiver of any appellate rights.

Respectfully submitted,

s/ Robert C. Mitchell
ROBERT C. MITCHELL,
United States Magistrate Judge

Dated: August 4, 2000